

KIATNAKIN BANK PLC

No. 53/2012

27 September 2012

Company Rating: A-

Outlook: Positive

New Issue Rating: A-

Rating History:

Date	Company	Issue (Unsecured/ Subordinated)
31/03/11	A-/Pos	A-/-
30/11/04	A-/Sta	A-/-
12/07/04	BBB+/Pos	BBB+/-
21/05/02	BBB+	BBB+/-
21/06/00	BBB	BBB/-
06/03/00	BBB/Alert Neg	-
25/11/99	BBB	-

Rating Rationale

TRIS Rating affirms the company and current senior debenture ratings of Kiatnakin Bank PLC (KK) at “A-”. At the same time, TRIS Rating assigns a rating of “A-” to KK’s proposed issue of up to Bt2,000 million in senior debentures. The ratings reflect the improvement in the bank’s business and financial profiles, its experienced management team, acceptable risk management practices, improving asset quality, and strong level of capital funds. However, the ratings are constrained by the bank’s moderate franchise value and limited distribution network compared with larger banks. Furthermore, KK’s future business growth and profitability might be affected by the changing economic and political environments, as well as intense competition in both the banking and securities businesses.

KK was ranked 11th among 15 Thai commercial banks in terms of total assets, with 1.8% market share in assets, 1.8% in loans, and 1.3% in deposits as of June 2012. KK’s core businesses in auto hire-purchase lending, residential project lending, and distressed asset management are well managed, with high levels of management expertise. KK’s loan portfolio has continued to expand, rising by 13% to Bt154.1 billion at the end of June 2012, from Bt135.7 billion in 2011. The growth was supported by rising domestic vehicle sales and a number of economic stimulus measures enacted by the Thai government. Of the total value of KK’s loan portfolio, 75% was hire-purchase lending, while 25% was residential project loans and other types of loans. As of June 2012, auto hire-purchase lending rose by 15% to Bt115.5 billion, compared with Bt100.8 billion in 2011. Loans for real estate and construction grew by 12%, from Bt23.3 billion in 2011 to Bt26.1 billion at the end of June 2012.

As a part of its growth strategy, KK successfully merged with Phatra Capital PLC (PHATRA) effective on 13 September 2012. KK made a tender offer for PHATRA by issuing new ordinary shares of KK to swap with PHATRA’s shareholders. PHATRA was ranked 10th among 32 active brokers in terms of trading volume as of August 2012. The collaboration between KK and PHATRA is aimed at the joint establishment of financial services businesses. After the merger, KK should have a greater competitive edge in its capital markets investment banking segment. KK’s business and financial profiles could further improve in the long term if KK can achieve the hoped-for benefits from group-wide synergies. However, the immediate benefits after the merger are not expected to be significant enough to change KK’s credit profile.

KK has a strategy to expand by focusing on good quality assets. To this end, the bank has recently imposed more stringent credit policies and underwriting criteria. KK’s non-performing loans (NPLs) have consistently declined over 2007-2011, falling from Bt8.2 billion in 2007 to Bt4.7 billion in 2011. However, in the aftermath of the severe floods in Thailand in late 2011, KK’s NPLs rose to Bt5.2 billion at the end of the second quarter of 2012. Despite the rise in NPLs, the ratio of NPLs to total loans, or the NPL ratio, remained controllable. The NPL ratio declined from 6.2% in 2009 to 3.5% in 2011 and 3.4% as of June 2012. At the same time, non-performing assets (NPAs; classified loans more than three months past due, plus restructured loans, and foreclosed property) were 5.0% of total assets by

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the end of June 2012, down from 6.0% in 2011. KK has made loans to small and medium sized residential developers. These loans were considered as high credit risk loans. The bank's NPL ratio for loans to the real estate and construction sectors remained high at 10.7% as of June 2012. Nonetheless, KK maintains an adequate cushion of capital and allowances for doubtful accounts. The cushion is enough to absorb the risks from the NPAs. The ratio of NPAs to capital funds plus the allowance for doubtful accounts improved from 0.61 times in 2009 to 0.41 times in 2011 and to 0.39 times as of June 2012. In the meantime, the bank's ratio of allowance for doubtful accounts to NPLs jumped to 106.9% in June 2012, from 69.7% in 2009 and 85.1% in 2010.

KK has been able to generate more income and sustain the high yields from its core businesses, while successfully controlling its operating costs. However, KK's funding cost was higher in 2011 through the first half of 2012. The bank also set aside more reserves for possible loan losses which may arise because of the floods. KK reported a net profit of Bt2,859 million in 2011, up by 1% year-on-year (y-o-y). In 2011, the bank's return on average assets (ROAA) and return on average equity (ROAE) were 1.7% and 12.3%, respectively, down from 2.1% and 14.2% in 2010. For the first six months of 2012, KK delivered net income of Bt1,395 million, up by 1% y-o-y. KK's profitability is likely to be affected by new regulations requiring an increase in the regulatory fee charges based on deposits and short-term borrowings. The cost of funds will rise because of a mandated increase in the fees paid to the Bank of Thailand (BOT), in order for the BOT to repay the debt burden of the Financial Institutions Development Fund (FIDF).

In terms of liquidity and funding, KK is exposed to some level of liquidity risk, as the bank has a maturity mismatch for assets and liabilities with less than 12 months duration. KK also relies on wholesale funding, which tends to be a more volatile funding source. As of June 2012, KK's funding structure comprised bills of exchange (B/Es), accounting for 31% of total deposits and B/Es, plus time deposits (51%), and current and savings deposits (CASA, 18%). However, KK has a strategy to increase the number of retail accounts in an effort to diversify and stabilize its sources of funding.

KK's capital base remained strong, as shown by a Tier-1 ratio of 13.3% and a total capital adequacy ratio (BIS ratio) of 14.0% as of June 2012. The bank's equity to asset ratio dropped to 11.1% at the end of June 2012, from 12.8% in 2011, as the loan portfolio expanded. As KK engages in high risk and high return lending, especially for residential project loans, it is crucial for the bank to maintain a strong capital base and stringent allowances for doubtful accounts. The capital base and allowances can absorb unexpected losses from future downside risks.

Rating Outlook

The "positive" outlook reflects the expectation that KK will be able to continue growing and sustain its profitability in the medium term. The outlook also reflects the bank's ability to control asset quality and maintain a level of capital funds sufficient to absorb any downside risks arising from uncertainties in the economic and financial environments. The major concerns remain the possible effects from the floods in Thailand and the possible rise in the cost of funds. KK's ability to sustain its strengths and to secure stable sources of funds at reasonable prices remains to be proved.

Kiatnakin Bank PLC (KK)

Company Rating:	A-
Issue Ratings:	
KK120A: Bt2,000 million senior debentures due 2012	A-
KK142A: Bt2,905 million senior debentures due 2014	A-
KK144A: Bt2,485 million senior debentures due 2014	A-
KK16DA: Bt975 million senior debentures due 2016	A-
KK187A: Bt240 million senior debentures due 2018	A-
KK18DA: Bt625 million senior debentures due 2018	A-
KK18DB: Bt10 million senior debentures due 2018	A-
Up to Bt2,000 million senior debentures due within 2014	A-
Rating Outlook:	Positive

Financial Statistics*

Unit: Bt million

	----- Year Ended 31 December -----					
	Jan-Jun 2012	2011	2010	2009	2008	2007
Total assets	223,865	189,996	143,107	127,414	114,733	87,227
Investment in securities**	56,963	32,123	19,070	22,820	7,994	11,348
Loans and receivables	154,932	136,547	107,899	87,638	81,360	66,670
Allowance for doubtful accounts	5,581	5,120	4,235	3,796	3,553	3,064
Deposits	106,614	69,040	75,931	76,109	71,156	41,354
Borrowings***	86,285	91,233	38,510	29,712	23,711	25,673
Shareholders' equity	24,821	24,264	22,118	17,946	17,167	16,932
Net interest income	3,348	6,476	5,826	5,067	4,503	3,743
Bad debts and doubtful accounts	716	1,278	470	684	990	644
Non-interest income	1,674	3,208	3,353	1,779	1,538	1,865
Operating expenses	2,640	4,985	4,629	3,063	3,005	2,407
Net income	1,395	2,859	2,840	2,229	1,867	2,111

* Consolidated financial statements

** Including investment in loans

*** Including interbank and money market

Key Financial Ratios*

Unit: %

	----- Year Ended 31 December -----					
	Jan-Jun 2012	2011	2010	2009	2008	2007
Profitability						
Net interest income/average assets	1.62 **	3.89	4.31	4.18	4.46	4.57
Non-interest income/average assets	0.81 **	1.93	2.48	1.47	1.52	2.27
Fees and service income/total income	11.33	10.85	10.36	9.44	8.68	8.18
Operating expenses/total income	31.33	34.37	38.19	30.17	32.20	28.72
Operating profit/average assets	0.81 **	2.05	3.02	2.56	2.03	3.12
Return on average assets	0.67 **	1.72	2.10	1.84	1.85	2.57
Return on average equity	5.68 **	12.33	14.18	12.69	10.95	12.26
Asset Quality						
Non-performing loans/total loans	3.37	3.47	4.61	6.22	8.68	12.30
Non-performing assets/total assets	4.95	5.94	8.88	9.94	12.91	18.26
Bad debts and doubtful accounts/average loans	0.49 **	1.05	0.48	0.81	1.34	1.08
Allowance for doubtful accounts/total loans	3.60	3.75	3.93	4.33	4.37	4.60
Capitalization						
Shareholders' equity/total assets	11.09	12.77	15.46	14.08	14.96	19.41
Shareholders' equity/total loans	16.02	17.77	20.50	20.48	21.10	25.40
BIS ratio	14.01	15.40	15.18	16.29	15.42	16.39
Liquidity						
Total loans/deposits***	100.56	99.89	111.26	90.97	99.57	132.12
Deposits***/total liabilities	77.40	82.48	80.15	88.00	83.75	71.78
Total loans/total assets	69.21	71.87	75.40	68.78	70.91	76.43

* Consolidated financial statements

** Non-annualized

*** Including bills of exchange

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